MULTIMEDIA UNIVERSITY

STUDENT ID NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2015/2016

BFN3084 – INTERNATIONAL FINANCE

(All sections / Groups)

16th OCTOBER 2015
3.00 p.m. - 5.00 p.m.
(2 Hours)

INSTRUCTIONS TO STUDENTS

1. This Question paper consists of **THREE** printed pages (excluding this cover page) with **FIVE** structured questions only.
2. Answer **ALL FIVE** questions. Mark distribution for each question is given.
3. Please print all your answers in the Answer Booklet provided.

QUESTION 1 (25 MARKS)

A U.S. firm holds an asset in Great Britain and faces the following scenario:

	State 1	State 2	State 3
Probability	30%	30%	40%
Spot rate	\$1.55/£	\$1.50/£	\$1.45/£
P^*	£3,000	£2,500	£2,000
P	\$4,650	\$3,750	\$2,900

Where:

P^* = Pound sterling price of the asset held by the U.S. firm
P = dollar price of the same asset

a. What is the expected value of the investment in U.S. dollars?

(3 marks)

b. What is the variance of the exchange rate?

(6 marks)

c. What is the "exposure" (i.e. the regression coefficient beta)?

(6 marks)

d. Can most of the volatility of the dollar value of the British asset be removed by hedging exchange risk?

(10 marks)

QUESTION 2 (20 MARKS)

Alpha and Omega Companies can borrow at the following rates:

	Alpha	Omega
S&P's credit rating	AAA	BBB
Fixed-rate borrowing cost	7%	10%
Floating-rate borrowing cost	LIBOR	LIBOR + 2.5%

a. Calculate the quality spread differential (QSD).

(10 marks)

Continued...

b. Develop an interest rate swap in which Alpha and Omega both agree to share the total cost saving at a ratio of 3:2. Assume that Alpha desires a floating-rate debt and Omega desires a fixed-rate debt.

(10 marks)

QUESTION 3 (15 MARKS)

Educare Trading Bhd. sold smarty books to Logico Corporation in Germany on credit and invoiced €30 million payable in three months. Currently, the three-month forward exchange rate is RM4.5/€ and the foreign exchange advisor for EducareTrading Bhd. predicts that the spot rate is likely to be RM4.0/€ in three months.

a. What is the expected gain/loss from the forward hedging?

(5 marks)

b. If you were the financial manager of Educare Trading Bhd., would you recommend hedging this euro receivable? Why or why not?

(5 marks)

c. Suppose the foreign exchange advisor predicts that the future spot rate will be the same as the forward exchange rate quoted today. Would you recommend hedging in this case? Why or why not?

(5 marks)

QUESTION 4 (20 MARKS)

a. Define the balance of payments and explain its four main accounts.

(10 marks)

b. Why would it be useful to examine a country's balance of payments?

(10 marks)

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QUESTION 5 (20 MARKS)

Currently, the spot exchange rate is RM3.78/$ and the three-month forward exchange rate is RM4.0/$. The three-month interest rate is 2.7% per annum in Malaysia and 2.0% per annum in the U.S. Assume that you can borrow as much as RM3,780,000 or USD1,000,000.

a. Determine whether the interest rate parity (IRP) is currently holding.

(7 marks)

b. If the IRP is not holding, how would you carry out covered interest arbitrage? Show all the steps and determine the arbitrage profit.

(7 marks)

c. Explain how the IRP will be restored as a result of covered arbitrage activities.

(6 marks)

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